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C O N F I D E N T I A L SECTION 01 OF 03 MUSCAT 000738

SIPDIS

FOR ABU DHABI/DUBAI: PLEASE PASS TO USTR

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TAGS: [PREL](#) [ECON](#) [EFIN](#) [ETRD](#) [MU](#)
SUBJECT: SCENESETTER FOR U.S. TRADE REPRESENTATIVE SCHWAB'S
VISIT TO OMAN (OCTOBER 24-26)

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Classified By: Ambassador Gary A. Grappo for Reasons 1.4 (b, d)

Introduction

¶1. (C) Embassy Muscat and I warmly welcome you to Oman. As one of our oldest friends in the region (the Omanis refer to their relationship with us as "strategic"), the Sultanate remains a trusted U.S. partner. This year marks the 175th anniversary of the U.S.-Oman "Treaty of Amity and Commerce," second oldest in the Middle East and North Africa. Thanks in part to the signing of the U.S.-Oman Free Trade Agreement in 2006, our economic relationship has grown deeper and opportunities for bilateral investment both here and in the U.S. have increased. All of your Omani interlocutors, who speak excellent English, are looking forward to your visit. Deputy Secretary of State John D. Negroponte recently visited Oman and told Sultan Qaboos that implementation of the FTA is a high priority for the Administration and explained that your visit would seek to address all remaining issues so that the agreement can enter into force before the end of the year. As you prepare for your visit here, I continue to strongly recommend that you provide clear redlines on the outstanding issues and in those areas not resolved by your departure, leave a comprehensive list of specific action items the Omanis must complete. I also suggest you consider proposing to Minister of Commerce and Industry Maqbool bin Ali bin Sultan a specific date for completion of all FTA issues and implementation. End Introduction.

Closing the Deal

¶2. (C) Thanks to some significant legal reforms, prompted in part by the FTA, the "doing business climate" has improved for all foreign companies in Oman. Although U.S. companies still sometimes find it hard to compete with British and other European counterparts in Oman, the government and business community has become more interested in seeking partnerships and business opportunities with U.S. firms. The FTA, once implemented, should further this trend and provide a real incentive to Omani companies to "Buy America" and further their ties to the U.S. Accordingly, I and others in the Embassy are constantly asked, "When will the FTA be implemented?" This is one issue that neither Oman nor the Embassy can dodge when speaking with Oman's business community as many large and small businesses have been waiting for the agreement's entry into force.

¶3. (C) As we mentioned in previous messages, the Omanis may be seeking compromise on some outstanding FTA issues, including telecommunications, transparency requirements, and

intellectual property and copyright regulation. I strongly recommend that you come prepared to map out specific limitations/redlines to present to Oman's negotiators on these issues. In addition, before your departure, I recommend that you provide a comprehensive list of action items that the Omanis must complete before implementation, along with a concrete timetable for action in order to help ensure that we wrap everything up before the end of the year.

A Growing Economy

¶4. (C) Oman's economy is based primarily on revenues derived from petroleum and natural gas, which accounted for 76.4% of the government's income in 2007. The main oil producer is Petroleum Development Oman (PDO), a majority government-owned company that partners with Royal Dutch Shell. It controls approximately 90 percent of the reserves and the lion's share of total production. With average daily production falling from 956,000 barrels per day (bpd) in 2001 to 710,000 bpd in 2007, the government has opened the sector to greater foreign participation in a bid to increase output. U.S.-based Occidental Petroleum, the second largest producer, is investing \$3 billion in enhanced oil recovery efforts for its recently acquired concessions.

¶5. (SBU) Despite declining oil production, high oil prices over the past several years have led to solid Omani budget surpluses and GDP growth. Oman's economy grew 12.9% in 2007 according to the Central Bank and produced an estimated \$4.5 billion surplus, which the government is using, in part, to improve oil production capabilities and locate additional gas reserves. In addition, the government is utilizing its revenues to strengthen the economy in the long-run by shoring

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up its pension fund, reducing its debt, and augmenting a number of reserve funds. Oil revenues also have allowed the government to proceed with plans to diversify Oman's economy through industrialization, port infrastructure expansion, and tourism development.

Infrastructure Development

¶6. (SBU) The largest single industrial investment target is the port city of Sohar, which has witnessed over \$12 billion in government investment alone. The Port of Sohar, a 50-50 joint venture between the Sultanate and the Port of Rotterdam, anchors the industrial development planned for the region. The Port of Salalah, located in the far south of Oman, is a key container transshipment hub for Maersk and its parent company, A.P. Moller (APM). The government is promoting the free zone adjacent to the port in Salalah with a package of incentives and is in partnership discussions with the Jebel Ali Free Zone Authority in Dubai.

¶7. (SBU) The Omani government is also developing a port at Duqm, a lightly populated area along the Arabian Sea. Master plans call for the construction of a dry-dock facility, oil refinery, petrochemicals complex, and a fish processing center. The Duqm development plan also calls for the construction of an airport to facilitate cargo shipments and tourism. In April 2008, the government awarded a \$440 million contract to Korean-based Daewoo and local contractor Galfar for the construction of Duqm's dry-dock. In consideration of plans to build 16 new luxury hotels in Oman over the next five years, the government is moving ahead on an ambitious plan to develop its airport infrastructure to accommodate increased tourist arrivals.

A Pressing Need for Gas

¶8. (C) With a major share of its domestic gas production

committed to long-term liquefied natural gas (LNG) export contracts, Oman urgently needs large quantities of gas to fuel its industrial development and port expansion plans. The government accordingly considers the acquisition of new gas supplies to be a vital national security issue and, after extensive review of alternatives, sees Iran as the only realistic supplier. Negotiations between Oman and Iran on the development of Iran's off-shore Kish gas field are ongoing, but the Omanis are growing increasingly frustrated with unreasonable Iranian demands on gas pricing and other issues. Oman also continues to look for alternative sources of energy. Recent reports have indicated that Oman plans to build at least two coal-fired power plants and is currently brokering a few experimental small-scale wind and solar power projects.

SMEs and Omanization

¶9. (U) Another avenue the government is pursuing to promote economic growth is the creation and support of small and medium enterprises (SMEs). The Ministry of Commerce and Industry formed a government directorate in 2007 devoted to the servicing of SMEs; the Oman Chamber of Commerce and Industry similarly created a committee to support SME activities. Moreover, several government entities, financial institutions, and large businesses offer financial assistance and training to aspiring entrepreneurs. Such activities have directly impacted the private sector, resulting in SMEs occupying a larger, though still limited, share of the market. However, due to differing definitions and cumbersome registration processes, it is difficult to obtain exact data on how much or how fast the SMEs are expanding.

¶10. (SBU) Another key aspect of the government's economic development plans is replacing expatriate workers with Omanis -- a process known as "Omanization." Under Omanization, the government requires businesses to meet employment quotas, which differ by sector and type of firm, for Omani nationals in hopes of securing future jobs for its growing youth population and preventing capital from leaving the country in the form of remittances and external investments. As a result, many firms that once relied almost exclusively on expatriate labor must now rely on Omani labor and expertise. This has posed challenges for many international and some local businesses as the Omani educational system is not tuned into the needs of the labor market. Many of Oman's educational and training centers accordingly have had to

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revamp their curriculum to better match the needs of businesses. Omanis constitute no more than 20% of employees in the private sector due to a traditional preference for the security and relaxed pace of public sector jobs; however, the Sultanate recorded a 15.3% increase in employment of Omanis in the private sector in 2007. At the same time, economic growth, increased foreign investment, and more international partnerships have contributed to a 4.1% increase in the number of expatriates in Oman over the last three years, according to government figures. By some estimates there are approximately 900,000 expatriate residents in Oman, accounting for roughly 30% of the total population.

Record High Inflation

¶11. (C) High inflation, recently peaking at an annual rate of nearly 14%, and the rising cost of living are significant concerns in Oman, evoking much public grumbling. Prices for many consumer goods, including basic staples, have risen sharply. Booming real estate values have led to skyrocketing rents and made home ownership much less affordable. Significant government spending on various construction projects, and the currency peg to the declining dollar, contributed to rapid increases in the prices of building materials and consumables. In response, the Sultan announced

a number of stabilization measures, including an increase in public sector salaries in February with the largest wage hikes (43%) for those at the bottom of the pay scale. The recent fall in global commodity prices should help alleviate inflationary pressures in Oman.

Weathering the Global Financial Crisis

¶12. (C) Despite public assurances from officials that Oman's economy has not been affected by the global financial crisis, the Sultanate's stock market dropped by almost 40% over the last five months while its banking system, formerly flush with cash, now suffers from a lack of liquidity as its access to financing from external sources becomes more restricted. Local business contacts have expressed concern over weakness in the financial sector, as well as the potential negative impact on the economy if a major business failure were to occur in Dubai. The Omani press generally applauded the financial rescue package adopted by the U.S. Congress, although some here allege the crisis shows that Oman should reject Western capitalism in favor of Islamic principles. (Note: Islamic banking is not permitted in Oman. End Note.)

Even with much tighter credit, a sharp market downturn and lower oil prices, Oman's economic growth should continue thanks to government spending on big infrastructure and development projects.

GRAPPO